RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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Nov. 19, DJIA 852.93; PTI 1410; A-D Ratio –22.96
Nov. 27, DJIA 885.94; PTI 1434; A-D Ratio –21.96

THE PICTURE: While down in New Orleans last week I spent a good deal of time with Doug Casey (author of the best selling *Crisis Investing*). We talked about the investment advisory picture and the very high mortality rate in this business. I noted that it is remarkable that with upwards of 50 million investors in stocks and bonds (some say it's double that figure) only about 10 advisory publishers earn a good living from their efforts (we both doubted that more than 10 really do well).

I told Doug that in the 23 years that I've been in this business, I've often mulled over that strange statistic. I've also written about the remarkable lack of staying power in the advisory publication industry. I guess I've seen a hundred or more services arrive on the scene. They generally struggle (some make it big for a while, usually on the basis of one well-publicized call) but the fact is that only four services that I know of have survived since the early 1960's, and I guess I'm the sole survivor from the '50's. Why? Why the disastrous record?

I would say that five factors are involved, and they are very interesting factors from both the standpoint of the advisers and their clients. Here, in my opinion, are the five critical factors that lead to the downfall of most investment publications. (1) Some advisers get too caught up with a single concept or method of market analysis. They insist on staying with the narrow system. Ultimately the method ceases to work (no single method works all the time) – and the service goes under.

(2) The adviser turns out to be a poor business man, his costs climb above his income, and his balance sheet deteriorates. One day his accountant calls and tells him, "Charlie, it's all over."

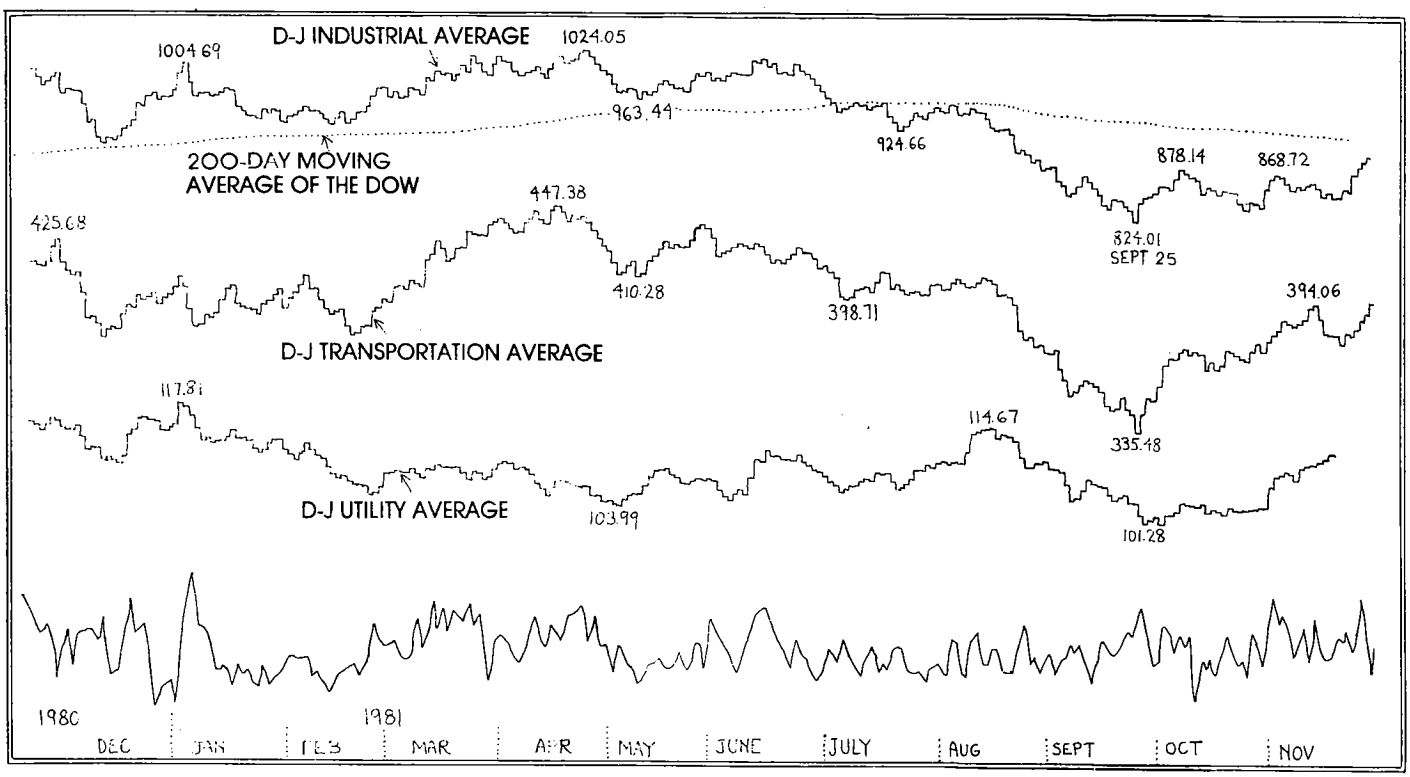
(3) The adviser "burns out." He can't take the constant pressure, and his wife or his physician or his own organs say, "Stop, that's all." Unfortunately, this is a very common occurrence in this business.

(4) The adviser publishes a service that is so downright dull that (right or wrong) no one will read it. I often tell new people in this business that "you might be the biggest genius on Wall Street, but if nobody wants to read your stuff you are going to end up as just another statistic."

(5) Here's a sad one, but a common one. The adviser insists on being a prophet, a genius, the "one and only darling of Wall Street." Why is this noble attempt so sad? Simply because it can't be done. Nobody writing about the stock market is that good, at least not for long. This kind of adviser promises too much, and when he fails to deliver on his promises his clients lose money, they get angry, and they exit. The failed genius is left alone to nurse his damaged ego and his fading publicity clippings.

Why am I writing about "tragedy in the advisory business." Because there's a lesson in each failure case, and the clients can learn as much from the case histories as the principles can. Remember, and this is something I learned the hard way over a quarter of a century of observations – the market is out to beat you. That may sound like a strange thought to the new investor, but it's true. Be it bull or bear, the market is a cunning animal that is bent on separating you from your hard-earned dollars.

It's the nature of the market beast to look his best when he's about to keel over. And the market looks worst, it looks absolute-



ly dreadful, when its about to turn to the bull side. This constant deception, this perpetual sham on the part of the market, is the phenomenon that costs perhaps 85% of the participants their money. Men and women live by their emotions. The market beast knows that, knows it very well, and he turns your own emotions against you in his never-ending struggle to destroy you.

This is the reason why we have to divorce ourselves from our emotions, our prejudices, our pre-conceived notions. You're a perpetual bear? Forget it, the market will send you to ruin. You're a confirmed bull? Welcome to bankruptcy. You say you can read the market 100% with your shiny new computer? Prove it with your money, my friend, not mine. You know for certain that the market is going to take a dive on December 29? Fabulous, but don't go too heavy on the short side, you might just be a week early – or a week late.

All right, have you absorbed all that? Now comes the PARADOX. You still have to develop some kind of personal rules or system *for yourself* – or you're not going to make it in the investment business. What do I do? I've developed my own rules and a philosophy, and I live by them, and I write about them for my subscribers. I also do a lot of thinking which really relates to economics and the very long term. Much of this thinking has to do with fundamentals such as "do I think the US auto industry can survive," or "do I think we can win in the battle with Russia?" That kind of thinking may tell me what might happen by 1990 or the year 2010, but it may be of very little use now – particularly in connection with the market.

As far as the stock market is concerned, I do have my own battery of indicators and devices, and they are led by the Dow Theory and my Primary Trend Index. So saying, let's get into what is happening right now – on Wall Street.

First, it looks as if my super-bullish buddy, Marty Zweig, could be right, at least for a while. From a Dow Theory standpoint, a lot has happened over the last week or so. Study the page 1 chart of the Averages. On November 27 the Dow rallied above the 878.14 peak of October 8 to close the week at a recovery high of 885.94. A confirmation (and this is a *critically important confirmation*) would require that the Transports push over their own November 12 high of 394.06. If that occurs, we will have a bullish looking structure under Dow Theory, and Industrials would then try to approach their 50-week moving average which now stands at 910. If Industrials can better 910 they will probably try for a further attack on the 925-935 area. But remember, for now the Transports *must better 394.06.*

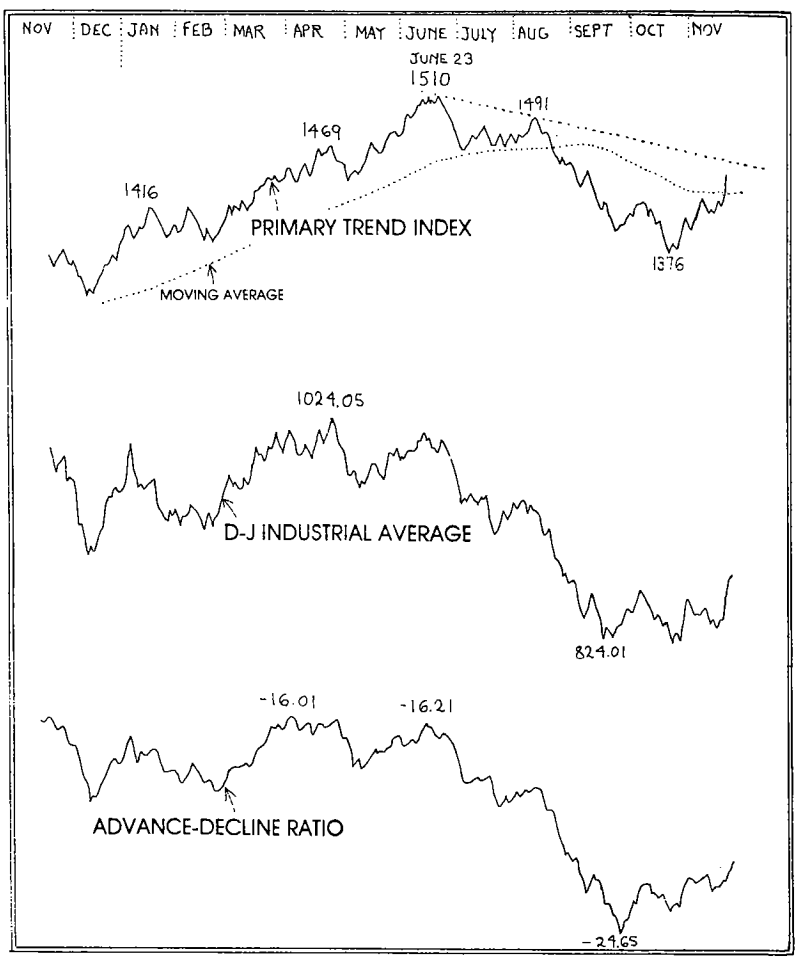
A further test of strength for this market entails the Utility Average. Back in August the Utilities rallied to 114.67. It would be a big plus for the market if the Utility Average now moved above the August high – to 115 or better (with interest rates coming down, this should be no problem for Utilities – *unless something is wrong*).

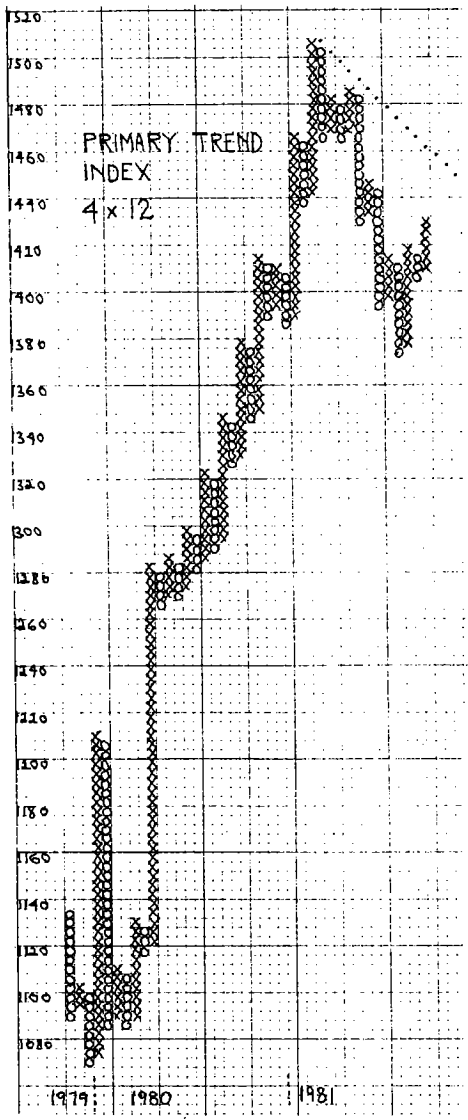
"All right," you say, "I understand what you're writing about. But in view of all this, why aren't you a bull, Russell?" And my answer is that I suspect that the primary trend is still bearish, and I suspect that we are simply seeing a trading situation. Here is another thought, and it is one that is undoubtedly on the minds of all veteran Dow Theorists. The Dow lost roughly 200 points on its descent from last April high 1024.05 to September's low of 824.01. Now EVERY movement in the market is subject to the normal 1/3 to 2/3 correction. A 1/3 normal correction of the April-September decline would take the Dow to 891, while a 2/3 normal correction would take the Dow back to 957. A correction of just 50% would take the dow to 924. So nothing startling has occurred so far, even as the Dow pushes above the 880 level.

Next I want to turn to my own proprietary device, the Primary Trend Index (see chart). This is the instrument that I have developed over the past 11 years, and it is a good one – it works. It doesn't tell us "all," it doesn't tell us how far a move will carry or exactly when that move will end. But the PTI does tell us (with cold, unemotional efficiency) the current direction of the technical sub-structure of the market. And when the PTI moves on a trend basis, well, you don't have to invest with it if you don't want – but you had better not fight it!

As you can see on the chart, a lot has happened since the last Letter. The PTI has formed a "head-and-shoulders bottom" (the October 26 low of 1374 was its bottom point), and last week the PTI broke above its October 12 resistance level at 1419 and also above its 21-day moving average which now stands at 1425. This breakout places the PTI in position to attack its main declining trendline which comes in at about 1452. If the PTI can better the major bear trendline (and that would be impressive), it would be in position to attack its July 13 high of 1491.

So what can we say in regard to the PTI? We can say this: the October 26 low of 1374 could be an important low – we don't know yet, but it could be. Second, the PTI has now formed a steep little uptrend – no question about it. Third, the first real test will come when the market corrects it's latest rise. At that time I want to see how the PTI acts.





I have included a point & figure chart (at left) of the PTI, and this chart places the PTI move in long-term perspective. Note that the PTI is moving out from a well-defined little base; nevertheless, all the action is taking place below the main bearish trendline, a trendline that has been drawn from the 1510 high. But if that trendline (at about 1460 on the P & F chart) is bettered, we're going to be thinking about a real change in the bear trend.

Now, going to the bottom of the chart we see that the A-D ratio (which is a proxy for the entire NYSE) has been pushing up. But the A-D rise has not been very impressive so far. Considering that interest rates have been coming down, and considering that better than 1/3 of all NYSE stocks are interest-sensitive, you would think that the A-D ratio would be stronger. But it just hasn't been the case. And new daily highs have (so far) been anything but impressive. On November 27 with the Dow at a recovery high of 886, there were only 43 new highs.

New highs mean upside breakouts, and those breakouts constitute impressive technical action. A lack of daily new highs means that most stocks are just pulling back to their 200-day moving averages – and that's action typical of a bear market rally. So the lack of new highs bothers me. It's not good action (although it can change).

Question: All right, Russell, the Dow Theory is still bearish (until proved otherwise), new highs are not coming in, the A-D ratio is sluggish, but the PTI is pushing up above its 21-day moving average. What do we do?

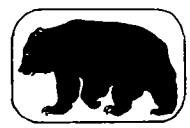
Answer: If you still own some stocks, sit with them. Sit as long as the PTI is rising. If you're a long term investor you're in a "decision area," and the decision is whether you should take some positions. I don't see enough here to make me think this is a historic long-term bottom. But you might start switching some funds into your favorite no-load fund just "in case" this turns out to be the beginning of the Ronald Reagan Super-Boom." You know as well as I do – that the market can do anything, and it damn well doesn't need our permission or sanction.

If you like to trade the market and you think you have the intestinal fortitude and discipline to do it right, then trade with the PTI, but do it conservatively. If you're trading with the PTI, as of this Letter you're on the bull side. This is a thought: if Wall Street is heading for a BIG move, then the market, judging from the A-D ratio, has a long way to go. The A-D is just a few points off its September low, and I've never seen a legitimate major move that didn't take the A-D with it – sooner or later.

Another thought: a lot of investors and traders wait for the first major decline, following the initial rally off the bottom. If that decline looks "right," they buy. We haven't had the decline yet, but count on it – it will come just when the market looks like it's heading straight for the moon.

Still another thought: the bull sector of the 233-day cycle (see last Letter) is due to turn down (to bear) around the middle of December. This suggests tough going for the bulls, and I am most interested to see if the PTI will continue its uptrend through the bear sector of the cycle.

INVESTMENT POSITION: The Fed is pumping, interest rates are down, and there's a lot of excitement being created by acquisitions and take-overs and rumors of the same. This has been moving the market up, but it's easy to be stubborn where Wall Street is concerned – and hard, very hard to be unbiased. I've known a lot of biased people in this business, and they make it big at times, and they lose it big at other times. So I try to stay neutral (unbiased) and that means listening to the market – and following it.

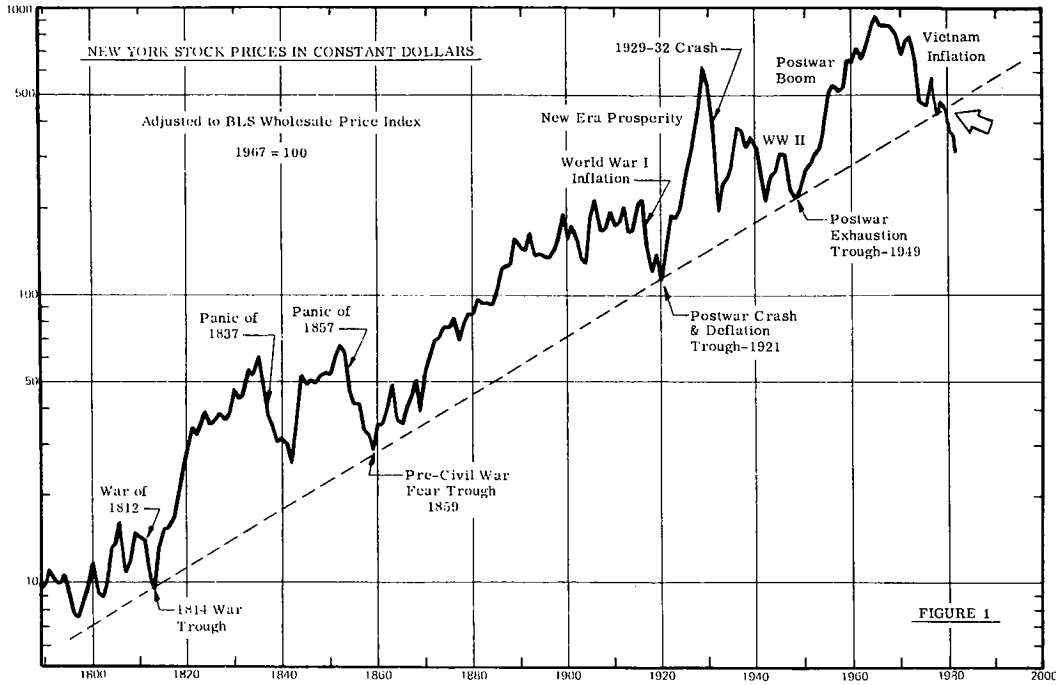


From a Dow Theory standpoint, the primary trend is always taken to remain in the direction of the last major signal. The last Dow Theory signal was from bull to bear, and that signal has not been reversed or rescinded. From the standpoint of the PTI, the secondary trend is bullish, but the PTI is moving up BELOW its last major trendline. The area above the last lows but under the primary highs is termed secondary territory, and there is always a lot of confusion about the trend when the market is in a secondary area. Thus, today's uncertainty and perplexity is par for the course.

Personally, I am always aware of the fact that I'm dealing with money, hard-earned after-tax money, and I don't at all mind holding my funds in T-bills while drawing 10% or more, holding it until I'm quite SURE of what's happening (and I'm not sure yet). Trading for 100 or less Dow points never excited me, and missing a move never cost me any lost sleep (being on the wrong side of a move has cost me lots of sleep, however).

For traders and long-term investors who want to take a calculated risk I like *Fidelity Equity Income Fund* (800-225-6190); they're at 82 Devonshire St., Boston, MA 02109. I also like *Mutual Shares* (212-908-4047) at 26 B'way, NYC 10004. *Scudder Development Fund* has also been a fine performer (212-350-8200) at 345 Park Ave., NYC 10022.

Among stock groups the strongest recently have been Communications (strong stocks: *Central Telephone, S. New England Telephone*), Electric Utilities *(New England Electric, Duke Power)*, Tobacco (*Phillip Morris, US Tobacco*) and Banking *(Marine Midland, Texas Commerce).*



The second chart shows the inflation adjusted path of stock prices in the US over the past 200 years (chart courtesy of *Hoppe Analysis*, Box 513, Crystal Lake, IL 60014). Here we see the breaking of a 200 year trend, a trend that was not even broken during the 1929 crash or at the 1949 historic low. What is this chart telling us?

Hoppe states, *"Whatever the NY stock market is discounting, it would seem that it is perceived to be a greater threat than anything that has happened to the US during the past 200 years."*

Frankly, I don't know exactly what this chart means, but I would have to say that it is a dangerous looking chart, and that it seems to be saying that drastic changes are coming. Those changes are most likely to be deflationary or at best destructive to stock values.

FOREBODINGS: It has bothered me for a long time that the entire nation is now positioned for more inflation. Everybody owes money, everybody is in debt, and, in fact, the whole nation is "loaned out" on the theory that you borrow current dollars and then pay off with cheap (inflated) dollars. Of course, this system of legal thievery has worked for a long time, and it has worked particularly well during the period of the 1970's to the present. But what happens when EVERYBODY (as now) is playing the same game? Do markets oblige everybody? The answer is hardly ever. Will the economy oblige everybody? I wonder.

These two charts together with the long-term action of gold (see Letter 820, page 6) have brought me to the edge of my seat. The lower chart (from C.J. Lawrence's Weekly Economic Date) shows the growth (annual rate of change) in the monetary base supply breaking a 30-year rising trend. The monetary base is the raw material of the money supply. Of course, the Fed can pump it up again, but I'm just showing where we are – not where things "might be if . . ." Obviously, this picture (if it continues) is deflationary and negative for business.

There are three other areas that I particularly want to watch now in conjunction with these two charts. One is gold. I am most anxious to see whether gold holds above its low of 392. Another chart I am watching is the turnover of demand deposits in the nation. This is literally the turnover of money in the US. If this chart breaks down, breaks its long upward trend, it will be a very deflationary sign. Yet another area is the price of houses in the US. As subscribers know, I consider home prices to be a critical area at this time. The fortunes of most Americans with assets are tied up in their homes. If the price of houses crack by say 40% to 50%, the nation will face depression. These then, are some of the things I am seeing and some of the areas I will be watching as we move into 1982.

NOTES & QUOTES: Don't know exactly why, but I've been besieged of late by questions from subscribers (it could be because of the large number of new subscribers over the last few months). At any rate, I've been reduced to scribbling the answers to questions on the margins of letters received here. I know that this is hardly the essence of politeness, but it is the only way I can get answers out on all the questions.

* *

Julian Snyder (publisher of "Moneylines") has just sent me a fascinating book. Julie wrote the preface. The book is entitled, *General Theory of Employment, Interest and Cheating* and it was written by a brilliant Frenchman, Yves Laulan (publisher, Richardson and Snyder). There is more economic sense in this book than anything I've read in a long time, and I recommend the book to my subscribers. Laulan says of the 1980's, they will be dominated by two areas, energy and defense.

* *

S. Africa may have the world's worst racial policy (or problem) but they have the world's best energy policy. Sitting on top of the largest coal deposits on earth, S. Africa has built two giant coal liquification plants and a third will come on steam in 1982 (cost: $6 billion for the three). When completed, S. Africa will be the energy envy of the world with 75% of its energy needs coming from liquid fuels (vs. 45% from liquid fuels for the US). S. Africa's policy on the plants: get them profitable and then sell them to investors. The US could take a page from the S. African book – but no, that would make too much sense.

* *

The state of California now expects its tax receipts to run about $757 million below the 1981-82 budget expectations. California's spending (surprise) is also running above expectations with a $50 million bill for fighting Med-flies plus a $200 million deficit in Medi-Cal. The state's famous reserve has now been wiped out, and it looks like red ink in the golden state.

* *

The auto industry is in dire straights. The combined earnings for 1980 and the first 9 months of 1981 are as follows: GM showed a loss of $526 million, Chrysler a loss of $2.14 billion, Ford a loss of $1.62 billion, American Motors loss of $287 million. Combined loss was $4.57 billion! If this continues through 1982, there is going to be major trouble. Layoffs so far of union auto workers is 207,000 with an estimated layoff of 400,000 in related industries. The October US auto sales were the worst in 23 years. *Item*:Toyota makes 9 engines per employee/day vs. Ford's production of 2 engines. *Item*: On Nov. 18 General Motors announced that it was going to borrow $4-6 billion for GM and GMAC. In my opinion, this could ultimately finish off GM as a solvent corporation. And imagine, they paid out dividends this year!

* *

I am indebted to my thousands of alert subscribers for keeping me informed regarding what's really happening in this world of ours. Here's a picture of the 500,000 peso bill from inflation ridden Argentina. Coming up: a million peso bill from Argentina. This bill will be worth $90 in US funds. Deflation may be in the wind in the US but it hasn't come to Argentina yet, where inflation is running at a 150% rate.

* *

COMPANY	6 Month Interest (in millions)	6 Month Pretax Profit (in millions)
AVCO	203	61
Sears, Roebuck	710*	242
Tiger International	92	33
Lockheed	87	45
GDV	58	30
Ashland Oil	57	33
American Airlines	62	36
City Investing	154*	93
Western Union	44	32
Singer	54	42
Dome Petroleum	193	151
NVF	55	48
RCA	186	168
U.S. Home	31	30
Sharon Steel	47*	46
Charter	52	51

*net interest after interest income and/or interest capitalization.

COMPANY	6 Month Interest (in millions)	6 Month Pretax Profit (in millions)
Braniff International	$ 49	$ – 62
Continental Airlines	30	– 39
Chrysler	139*	–269
Filmways	37	–111
Pan American World Airways	70	–211
Warner-Lambert	38	– 38
Ford Motor	315	–298
United Airlines	69	– 43
Coastal	98	– 38
Republic Airlines	57	– 20
Eastern Airlines	70	0
Jim Walter	81	1
F.W. Woolworth	81	1
Evans Products	35*	2
AVCO	203	61

With the dip in interest rates, corporations are lined up in record numbers to convert their short-term debt to long-term. In many cases, the debt load is tremendous. Here's a list of stocks whose interest costs are greater than their pre-tax profits. Can you imagine what will happen when sales and profits start sliding!

* *

Inflation may be with us forever, but housing prices are now soft, softer than at any time since World War II. This little clip from the *NY Times* tells the story. Here in California, financing has been a matter of loans and loans on the loans. This cartoon from last week's *New Yorker* would seem to represent a comment on today's home financing.

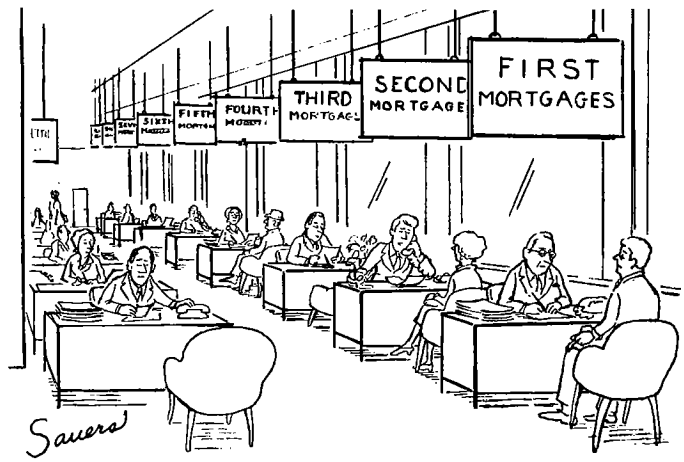
By THOMAS L. FRIEDMAN

After more than a decade of steady increases, prices of homes in the United States have begun to level off, and in many areas they have begun to decline.

After adjustment for inflation and financing discounts, the average price of existing homes has fallen 10 percent in the last 12 months, the steepest drop since the Depression.

To be sure, the recent decline in the inflation-adjusted price of homes is insignificant compared with the substantial appreciation many homeowners have built up during the last decade, when average prices virtually tripled. Nonetheless, this sudden price erosion has brought into question the future investment value of homes and the role of home ownership in the American family's financial planning.

Although real estate experts believe housing will still be a safe long-term investment, they say it may no longer be the instrument for savings and speculation that it was in the past. People will have to learn to seek protection from inflation through a wide range of financial assets other than their homes.



There's something strange happening in Britain, and I believe it's happening in America too. Despite rising unemployment, high interest rates and warnings of recession, people are still spending their head off. And I find that trend ominous (if the public feels everything's all right, it's probably time to worry). Anyway, I note here in La Jolla that the restaurants are still full, the stores are still selling the goods and nobody seems to be saving for a rainy day. This column is from the October 10 London *Economist.*

> Britain's consumers refuse to believe in the recession. Although real personal disposable income fell 2½% between the first and second quarters of this year, consumer spending was almost unchanged in real terms.
>
> Despite the depth of the recession in other areas, consumer spending has fallen only 2½% since its peak in the April-June quarter of 1979—a peak that was artificially inflated by a spending spree before Vat was increased. Between the second quarter of last year and this, consumer spending rose by 1% while real disposable income fell by 3%.
>
> Consumers have financed their spending by cutting down savings and by borrowing from banks. The savings ratio fell from 16½% (of personal disposable income) in the last three months of 1980 to 14½% in the first quarter of this year,

The sale of corporate tax credits is a total give-away by the US Government. It is estimated that the tax credit sales could cost the Treasury over $3 billion. And speaking of costs, the US unemployment rate is now 8%. It costs the Government roughly $27 billion in insurance and entitlements for every 1% rise in the unemployment rate. Thus, with debt this high and entitlements out-of-control, a recession becomes a compounding horror for the Treasury. As tax receipts fall off, expenses go up via the costs of unemployment insurance and benefits.

* *

On the way back from New Orleans I read "The Industry" by David Saul (Times books), a fascinating account of writing, directing and producing in Hollywood. If you want some concept of the Hollywood jungle, I recommend it. I sent my copy to buddy and producer, Aaron Russo (he did "The Rose" with Bette Midler and the coming "Partners" with Ryan O'Neil), "Aaron, " I wrote, "say it isn't so."

* *

BACK: Well, I got back safely from a whirlwind trip to New Orleans and the very successful seminar of (3000 attendees) Jim Blanchard's *National Committee for Monetary Reform*. I met friends from all corners of the earth: Tony Henfrey (S. Africa), Mark Tiers (Hong Kong), Aden sisters from Costa Rica (two very sharp analysts specializing in gold), good friend Harry Browne from Switzerland, Marty Zweig, Jerome Smith, Louis Rukeyser, Jake Bernstein, Tom Holt, Myron Kaller and family, Monte Guild. Spent a lot of time with Doug Casey ("Crisis Investing") who is off to the Grand Caymans this week and then Australia.

Had an interesting conversation with guest of honor, Ayn Rand (author of *Fountainhead, Atlas Shrugged*). We talked about age (she's in her 70's), and the necessity of having intense interests. She said she would love to see the year 2000. I replied that I had made a study of people who live to be over 100, and I was convinced that she'd make it. She seemed pleased at the prospect.

In all, it was a very interesting conference, and I enjoyed every minute of it (Mike Kaller even gave me a lesson in detecting faults and defects in postage stamps). The general consensus at the Conference was that interest rates would be heading down into and perhaps throughout 1982. I took a contrary opinion on that one.

Only three speakers (Harry Browne, Jake Bernstein, Harry Schultz) agreed with me on the following: I feel that the rest of 1981 and most of 1982 are going to be one long series of frustrations for traders. There are going to be shocks in business and finance, Government attempts at mitigating the pain, violent crosscurrent, and lots and lots of trading losses. In the end, the 10% plus that investors should average on T-bill roll overs could be more profitable and a lot more comfortable than any series of trades that one may attempt as we move into and through 1982.

Coming back from New Orleans I did a lot of thinking and one of the areas that puzzles me is the US auto industry. The picture here is frightful, but nobody seems to be paying much attention to it. My feeling is that ALL FOUR of the auto companies could be in deep financial trouble next year. GM with a collapsing balance sheet is cutting back in all directions on its supposed $40 billion four-year expansion and rebuilding plan. If auto sales continue to slump into 1982, the Fed may be called upon to bale the entire industry out. Under the pressure of high US auto prices, Japanese competition and a cash squeeze, the auto industry is sinking into an ocean of red ink.

LATE NOTES: On Monday, November 30 the Transports confirmed the Industrials action by rising to a new recovery high of 395.19. At the same time the PTI pushed to 1442, well into the distribution area as seen on the page 3 point & figure chart. Strangely, the breadth has still not come through strongly. Almost all major advances of the past have been "signalled" by three days or more in which advances were 1000 or better. The last time this occurred was in early June.

The PTI is the indicator I am watching or I should say scrutinizing now. As long as the present uptrend in the PTI remains intact, the pressure on the market is going to be on the upside. The big question as far as the PTI is concerned–can the PTI reverse its major downtrend line from the June high–and then make an assault on the 1510 high?

GOLD: As you can see on the point & figure chart, gold sank from its secondary high of 720 down to a 1981 low of 396. Then it broke out of its long down-channel, touching a high of 460. Most recently, gold came down to test its low of 396. That test (a few weeks ago) was at least temporarily successful, and last week gold rallied to 415. All this occurred in the face of almost universal forecasts that the yellow metal was heading into the 200's to low 300's. We'll see.

Some of the fundamentals are falling in place, fundamentals which would be bullish for gold. The main fundamental that I see is that the budget deficits for 1982 and beyond are going to be horrendous, and it's almost as if the deficits have taken on a life of their own. Congress watches as if hypnotized, Reagan plans (and maybe he's justified) ever bigger military spending, Social Security eats away at the very solvency of the nation, and a recession threatens to drop tax-receipts to the Treasury into the basement. All these separate disasters have the Fed backed against the wall, and gold wonders how much of the coming deficits will be monetized and how much of that monetization will be translated into further dilution of the dollar.

The 5-week moving average of gold now stands at 415, the 13-week stands at 423 and the long-term (primary) MA stands at 465. So far, the MA studies for gold remain bearish.